

# Weekly Economic Commentary

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### Highlights

- The Fed's Beige Book, China, and retail sales are likely to dominate this week.
- The household employment survey suggested that the labor market improved noticeably as 2010 ended.
- The survey of businesses painted a more subdued picture of the labor market in December.
- How can the economy grow and consumers spend against the backdrop of tepid job growth?

### Economic Calendar

<b>Tuesday, January 11</b> Wholesale Inventories <i>November</i>	<b>Friday, January 14</b> CPI <i>December</i>
<b>Wednesday, January 12</b> Import Price Index <i>December</i>	Retail Sales <i>December</i>
Treasury Statement <i>December</i>	Capacity Utilization <i>December</i>
Beige Book	Industrial Production <i>December</i>
<b>Thursday, January 13</b> Trade Balance <i>November</i>	U of Mich Consumer Sentiment <i>January</i>
Initial Claims <i>wk 01/08</i>	Business Inventories <i>November</i>
PPI <i>December</i>	

## A Tale of Two Surveys

The release of the Fed's Beige Book, a qualitative assessment of the economy in each of the 12 regional Federal Reserve districts, along with the December retail sales report highlight a busy week of U.S. economic data. Data on the export sector, import prices, consumer and producer price inflation, as well as the regular weekly readings on jobless claims, retail sales and mortgage applications are also due out. China will begin to release its full slate of December data this week, and central banks in Europe, the U.K., South Korea, and Thailand all meet to set interest rates. Of those central banks, only Thailand is expected to raise rates. Markets will also reflect back on yet another disappointing report on the U.S. labor market.

## The Fed's Beige Book, China, and December Retail Sales Are Key This Week

This week, market participants will likely be focused on the release of the Fed's Beige Book, the economic data in China, and the December retail sales report, which will likely put a bow on the successful 2010 holiday shopping season. The Beige Book will cover the time period from the last Federal Open Market Committee (FOMC) meeting on December 14 and early January 2011. Holiday shopping is likely to be a big theme, as is the unusually cold and wintery weather that impacted various parts of the nation during this period.

The Beige Book is likely to continue to show that while the U.S. economy continued to expand while 2010 ended and 2011 began, it was not growing fast enough to push inflation higher or the unemployment rate lower. The next FOMC meeting is January 26. We reiterate our assessment that the while the hurdle for ending QE2 remains high, the hurdle for the Fed to begin QE3 in June 2011 is even higher. The market is not expecting the Fed to raise rates until early 2012.

Over the weekend of January 8–9, 2011, Chinese authorities began releasing the economic data for December. The remainder of the data will be released over the course of this week and next week (January 17–24). As of early Monday, January 10, only the December import and export data has been released. The data showed further deceleration in exports and a flattening out of imports as 2010 ended, suggesting further slowing in the Chinese economy occurred in December 2010. Looking ahead, market participants continue to express concern over China's interest rate policy. China raised rates by 25 basis points on Christmas Day. The Christmas



## 1 Chinese Imports Continue to Decelerate, But Economy Probably Not Slowing Fast Enough to Forestall More Rate Hikes



Source: China Customs/Haver Analytics 01/10/11

We continue to expect more tightening of policy in China in the coming weeks and months as policymakers attempt to cool inflation.

rate hike was the second in ten weeks, and has been accompanied by no fewer than six increases in reserve ratio requirements for Chinese banks over the past 12 months. Thus far, market reaction to the latest round of interest rate hikes in China has been surprisingly muted, especially relative to early 2010, when China's early attempts at tightening policy were met with a severe downdraft in both global commodity and equity prices. The economic data in China has been slowing (albeit from a very rapid pace of growth) since early- to mid-2010, and more deceleration is likely into 2011. Real GDP growth in China is expected to be near 9.5% year-over-year in the fourth quarter of 2010, and is expected to grow at that pace in 2011 as well. Real GDP growth began the year at 12.0%. We continue to expect more tightening of policy in China in the coming weeks and months as policymakers attempt to cool inflation.

December same-store sales from the 32 retailers that report monthly results were mixed. More retailers missed targets than exceeded them, although the average increase was near expectations around +3.1%. High-end retailers performed very well, along with most teen retailers, while the biggest misses (relative to expectations) came from apparel retailers. Several cited weather disruptions (heavy rains in the West and blizzards in the Midwest and East around Christmas) for reduced sales activity. Combined with November's solid 5.4% year-over-year gain, holiday shopping (as measured by same-store sales) rose by 4.3% in 2010, nearly three times the pace of the 2009 holiday shopping season (+1.7%), and was the most robust holiday shopping season since 2006 (+4.4%). The government's much broader measure of retail sales (and holiday shopping) is due out Friday, January 14.

## Yet Another Disappointing Jobs Report

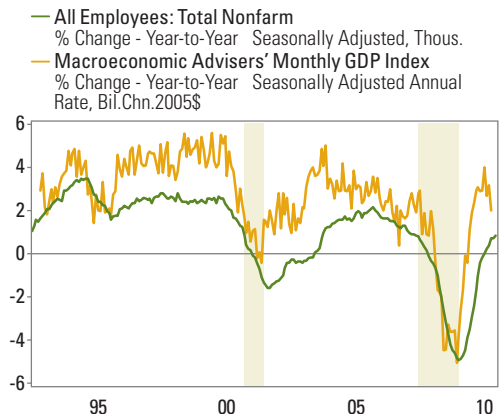
The U.S. economy created just 103,000 jobs in December 2010, far fewer than the consensus expectation of 150,000, a major disappointment relative to raised expectations in the wake of the very strong December ADP employment report that was released earlier in the week. While there were a few bright spots in the December 2010 jobs report, including upward revisions of 70,000 jobs to prior months job counts, a surprising drop in the unemployment rate (to 9.4%), and decent gains in manufacturing and retail employment, the report suggested that the economy is still not growing quickly enough to generate substantial job growth.

As we note often in these pages, the monthly employment report is actually two reports in one. The household survey, which generates the unemployment rate, is conducted by surveying tens of thousands of households across the United States each month and asking members of the household about their employment status. Are you employed? Are you looking for work? How long have you been looking? This household survey revealed that in December 2010:

- The economy added 297,000 jobs and 1.2 million in all of 2010
- 556,000 people fell off the unemployment rolls



## 2 The U.S. Economy Almost Always Grows Faster Than Employment Does



Source: BLS, MA 01/10/11  
(Shaded areas in chart indicate recessions)

As noted in our *2011 Outlook*, our view is that the job market will stage a comeback with nearly twice the pace of job creation experienced in 2010. Over the course of 2010, we expect the unemployment rate to fall gradually to around 8.5 to 9.0%, as the pace of hiring modestly outstrips the gain in the labor force.

- 260,000 people left the labor force
- The unemployment rate (the number of unemployed persons/the number of persons in the labor force) fell to 9.4% in December from 9.8% in November

In general, the household survey is more closely aligned with the weekly report on initial jobless claims data. In this dataset, state governments tally how many people file a claim for unemployment insurance. On average, the number of persons filing new applications for unemployment insurance in the four weeks ending January 1, 2011 was the lowest since the summer of 2008. The number of new claims filed each week has dropped by 230,000 since peaking in April 2009. The number of persons receiving any type of unemployment insurance has dropped from nearly 15 million at year-end 2009 to 8.5 million at year-end 2010. In short, the household survey suggests that the labor market is on the mend, although at an agonizingly slow pace.

The second of the two employment surveys in the monthly jobs report is the establishment survey. In this survey, the U.S. Bureau of Labor Statistics surveys "approximately 140,000 businesses and government agencies representing approximately 410,000 worksites throughout the United States" each month. This survey generates the nonfarm payroll job count that is widely cited in the press. The "establishment survey" tells us that the economy generated 103,000 jobs in December, although there was a net upward revision of 70,000 to the job count over the prior two months. Over the course of 2010, the private sector economy added 1.4 million jobs, or an average of around 120,000 per month. December 2010 was a typical month for job creation in 2010. As noted in our *2011 Outlook*, our view is that the job market will stage a comeback with nearly twice the pace of job creation experienced in 2010. Over the course of 2010, we expect the unemployment rate to fall gradually to around 8.5 to 9.0%, as the pace of hiring modestly outstrips the gain in the labor force.

One question we answer often is how can the economy grow, the consumer spend, and corporations make profits if the labor market is sluggish? The nearby chart shows that over the past 20 or so years, employment growth in the United States has consistently trailed growth in real gross domestic product (GDP). Productivity (output generated by each hour worked) and a strong export sector help to account for some of this discrepancy. Secondly, despite tepid job growth, incomes are growing, as more than 90% of the labor force is employed and, in general, those workers are seeing their hours worked increase and are receiving (modest) pay increases. In addition, government programs (like the aforementioned unemployment insurance program) have helped to support income growth.

In the 12 months ending in November 2010 (the latest data available), personal income has risen by 4.0% and is at an all-time high. In a historical context, 4.0% income growth is roughly two-thirds of the pre-Great Recession average income growth of the past 25 years (6.0%). This slow rate of growth for personal income has helped to keep a lid on consumer spending. In order for consumer spending to be more robust in 2011 than



it was in 2010—real personal spending increased by around 3.0% in 2010—income growth and, in turn, job growth, will have to be more robust.

Finally, corporation's profit margins in 2010 were close to all-time highs, as corporations remained reluctant to hire despite both domestic and global economic expansion. Labor costs account for around 70% of business costs, so holding back on hiring is a great way to boost profits in a low sales environment. In addition, it is important to note that economy-wide, around 40% of corporate profits come from outside of the United States, where some emerging market economies grew at nearly triple the pace the United States did in 2010.

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Stock investing involves risk including loss of principal. Past performance is not a guarantee of future results.

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